Grant Thornton

Accountants and Business Advisors

May 17, 2007

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Via e-mail: (comments@pcaobus.org) and Hand Delivery

Re: PCAOB Rulemaking Docket Matter No. 017, *Concept Release Concerning Scope of Rule 3523, Tax Services for Persons in Financial Oversight Roles* (PCAOB Release No. 2007-02)

Dear Board Members and Staff,

Grant Thornton LLP ("Grant Thornton") appreciates the opportunity to comment on the two questions raised in the Public Company Accounting Oversight Board's ("Board" or "PCAOB") *Concept Release Concerning Scope of Rule 3523, Tax Services for Persons in Financial Oversight Roles* (the "Concept Release"). We strongly support the Board's commitment to strengthen the ethics and independence of registered public accounting firms ("registered firms") that audit U.S. public companies' financial statements. As a leading public accounting, tax, and business advisory firm, Grant Thornton welcomes the opportunity to provide comments on key questions and issues affecting the criteria used to establish registered firms' independence.

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The section below outlines the PCAOB's questions as set forth in the Concept Release and includes Grant Thornton's comments.

PCAOB questions and Grant Thornton comments

PCAOB question 1:

To what extent, if any, is a firm's independence affected when the firm, or an affiliate of the firm, has provided services to a person covered by Rule 3523 during the portion of the audit period that precedes the professional engagement period?

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Grant Thornton comments:

Grant Thornton continues to support the intent of Rule 3523 to separate audit services provided to public company audit clients ("issuer client(s)") from tax services provided either to individuals in financial reporting oversight roles at issuer clients or to these individuals' immediate family members ("restricted person(s)"). We understand the Board's view that the provision of tax services, such as recommending tax filing positions, preparing income tax returns, and giving tax advice, to restricted persons creates the appearance of mutuality of interest with these persons and may not coincide with the best interests of issuer clients. We also understand the Board's view that registered firms cannot employ adequate safeguards to mitigate the appearance of mutuality of interest.

However, Grant Thornton believes that when tax services provided to restricted persons are completed or terminated before an audit engagement period begins, the relationship ceases to exist, and therefore there is no mutuality of interest. To be consistent with Rule 3522, the proposing registered firms should evaluate whether any recommended tax positions do not meet the "aggressive tax position transactions" criteria. If the registered firm concludes that these services are compatible with Rule 3522 criteria, the firm should discuss its conclusions with the issuer client's audit committee. Assuming that the registered firm can comply with the confidentiality provisions in the local jurisdiction's tax requirements and the appropriate audit committee communication has taken place, the PCAOB should permit the registered firm to use additional safeguards, such as separating the tax services team, which previously provided services to restricted persons, from the audit engagement team.

Transition to successor tax providers

To facilitate the transition to successor tax providers, Grant Thornton believes that, as a practical matter, the Board should permit registered firms' tax services professionals to freely communicate with successor tax services providers, since this communication would not impair the registered firms' independence. For example, in the event of a subsequent tax examination of an open year, we would request that the Board permit a registered firm's tax service professionals to exercise open and frank communications with the successor tax providers. Further, with the pre-approval of the issuer client's audit committee, the registered firm should be permitted to serve as fact witnesses in any tax examination or tax court process, as permitted under the January 2003 SEC independence rules.

To further support the need for open and frank communication with successor tax providers, IRS Circular 230, Sec 10.28, requires tax services providers to give former clients access to documents prepared by these providers, including any returns, affidavits, appraisals, or any other documents, if these taxpayers need such documents to comply with their current federal tax obligations. Similar requirements exist in many states and foreign jurisdictions, as well as in professional ethical regulations. *See e.g.*, AICPA Code of Conduct Interpretation 501-1 (ET Section 501.02) addressing ethical responsibilities for transmitting accounting records or other documents to a former client that are in the firm's custody.

Transactions subsequently not upheld by taxing authority

Based on the relevant facts and circumstances, Grant Thornton requests that the Board conclude that a registered firm's independence is not impaired, pending a review by and the approval of the issuer client's audit committee, when any tax filing position is subsequently determined to be an aggressive, listed, or confidential transaction or is subsequently not upheld upon examination by a taxing authority. The answer to Question #4 in the PCAOB Staff questions and answers on independence matters that was issued on April 3, 2007, which discusses the effects on a registered firm's independence of the Internal Revenue Service's subsequent listing of a transaction marketed, planned, or opined in favor of by the firm, supports this position.

In its response to Question #4, the Staff concluded that such a transaction would not retroactively affect the registered firm's independence. However, the firm would need to make a determination that it was independent when it planned, marketed, or opined in favor of the transaction. As discussed in the Staff's response, this would depend on the facts available at that time and on the transaction's compatibility with the criterion set forth in Rule 3522 ("at least more likely than not to be allowable under applicable tax laws") when the transaction was proposed by the firm.

PCAOB question 2:

What effect, if any would the application of Rule 3523 to the audit period have on a company's ability to make scheduled or unscheduled changes in auditors? Could the effect be minimized or managed through advance planning or otherwise?

Grant Thornton comments:

Narrowing of firms to provide tax compliance or consulting services

Rule 3523, excluding the July 31, 2007 extension of the application to new issuer clients, concludes that independence is impaired if registered firms provide any tax compliance or consulting services to restricted persons during **both** the audit and professional engagement periods.[1] We believe this requirement limits the ability of larger issuers with international operations to change their auditors of record easily. Many accelerated filers with international operations use one international

[1] Under Rule 3501(a)(iii) the term "audit and professional engagement period" includes both –

(1) The period covered by any financial statements being audited or reviewed (the "audit period"); and

(2) The period of the engagement to audit or review the audit client's financial statements or to prepare a report filed with the Commission (the "professional engagement period") –

(A) The professional engagement period begins when the registered public accounting firm either signs an initial engagement letter (or other agreement to review or audit a client's financial statements) or begins audit, review, or attest procedures, whichever is earlier; and

(B) The professional engagement period ends when the audit client or the registered public accounting firm notifies the Commission that the client is no longer that firm's audit client.

(3) For audits of the financial statements of foreign private issuers, the "audit and professional engagement period" does not include periods ended prior to the first day of the last fiscal year before the foreign private issuer first filed, or was required to file, a registration statement or report with the Commission, provided there has been full compliance with home country independence standards in all prior periods covered by any registration statement or report filed with the Commission.

accounting firm and its affiliated firms[2] for audits, another international accounting firm and its affiliated firms for assistance with documenting and testing the design and operating effectiveness of their internal controls over financial reporting, and yet another firm and its affiliated firms for their tax compliance and consulting services. Therefore, when restricted persons engage other international firms or their affiliated firms for personal tax compliance or consulting services, the availability of firms qualifying to provide audit services to issuer clients narrows even further. While issuer clients may offer tax compliance services as an employee benefit to ensure compliance and consistency, many do not select the tax service providers for their restricted persons nor track the providers that the restricted persons use.

Challenges audit committees and registered firms face due to mergers of network firms

Audit committees and registered firms that are members of international network firms face additional challenges due to mergers of network firms, acceptance of new member firms into the network, or changes in network affiliation during issuer clients' fiscal periods. These mergers, new members, or changes in network affiliations are largely beyond the control of an individual registered firm. We recommend that the transition period currently applicable to hires, promotions, or other changes in employment[3] be modified to apply to changes that occur when registered firms or their affiliates undergo business combinations or restructuring. Under the current transitional guidance, in-process tax engagements for a newly promoted or hired restricted individual must be completed within 180 days of the individual's acceptance of a financial reporting oversight role. The application of the 180-day transition to these circumstances would provide audit committees with greater flexibility to select auditors of record that best meet their requirements. Furthermore, an extension of the transition provision greatly enhances the abilities of existing auditors of record and potential new auditors to provide audit services to issuer clients.

Limitations confronting audit committees

Audit committees may plan for audit-firm rotation through advance notice to registered firms seeking proposals for ratification by stockholders at the issuers' annual meetings. This may give registered firms an opportunity to terminate ongoing tax service engagements with restricted persons. However, we generally find that requests for proposals to become auditors of record are generally made after an issuer has filed its annual report with the U.S. Securities and Exchange Commission ("SEC" or "Commission"). Therefore, if a firm receives an issuer's requests for proposals after filing Forms 10-K or 10-K/SB, the registered firm's independence is impaired if their tax professionals prepared or reviewed restricted persons' personal tax returns for the previous tax year, even if such returns were filed on time without extension. Audit committees

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[2] Under Rule 3501(a)(i) The term "affiliate of the accounting firm" (or "affiliate of the registered public accounting firm" or "affiliate of the firm") includes the accounting firm's parents; subsidiaries; pension, retirement, investment or similar plans; and any associated entities of the firm, as that term is used in Rule 2-01 of the Commission's Regulation SX,17 C.F.R. § 210.2-01(f) (2).

[3] Rule 3523 (c) provides a transition rule as follows—the person was not in a financial reporting oversight role at the audit client before a hiring, promotion, or other change in employment event and the tax services are –

> (1) provided pursuant to an engagement in process before the hiring, promotion, or other change in employment event; and
> (2) completed on or before 180 days after the hiring or promotion event.

Furthermore Question and Answer 6 in the PCAOB Staff April 3, 2007 release expands the scope of an "other change in employment event" to cover situations where an employee moves into a financial reporting oversight role because of a business combination.

currently need to identify all tax services providers used by restricted persons only to solicit proposals from independent registered firms. Therefore, Grant Thornton believes that this places additional burdens on the audit committees' ability to select registered firms that best match their needs and requirements.

Request for additional clarification of "material subsidiaries"

Under the Board and SEC independence requirements, registered firms and their affiliated firms must be independent of issuers to serve as their auditors of record. Therefore, the application of Rule 3523 to issuers' material subsidiaries for which affiliated firms will potentially perform audit services creates additional complexity for international issuers. In addition to guarding against prohibited nonaudit services to issuers, the audit committees and proposing firms must assess their independence with respect to restricted persons at issuers' material subsidiaries.

Therefore, in their requests for proposals, audit committees need to identify restricted persons at all subsidiaries in addition to officers and directors at the group, holding company, or issuer levels. If the audit committees narrow the roster of restricted persons to material subsidiaries, they need to specify the criteria used for this determination, since the proposing firms may come to different professional conclusions. We believe the PCAOB should provide clarification and guidance on the criteria that audit committees and registered firms should use to identify material subsidiaries for this particular purpose. This would enable audit committees and registered firms to consistently evaluate and determine the materiality of subsidiaries.

Need for clarification of "associated person"

We would also ask the Board to clarify what the term "associated person" means in the phrase "financial statements ... audited by a firm that is an associated person of the registered firm." Currently, uncertainty exists because the PCAOB criteria regarding the independence rules do not link to other PCAOB standards, and the term "associated person" is not defined within the context of the PCAOB independence and ethics requirements. As discussed by Question 21 of the PCAOB Q&A Release 2003-011, registered firms must make reasonable efforts to determine whether any persons that work ten or more hours in a year on issuers' audit engagements are associated with other registered firms. Question 21 indicates that reasonable inquiries include contacting other firms for information on whether they (their firm) are, or expect to be, registered with the Board. If these individuals are not associated with other firms that have not or do not intend to register, the persons or their firms are considered an "associated person". Therefore, the Board should clarify and define the term "associated person" as it relates to the application of Rule 3523.

In applying the materiality exception coupled with the "associated person" definition from Rule 2100, audit committees and registered firms may inconsistently apply Rule 3523. For example, some audit committees and firms may conclude that the materiality requirement covers all firms that perform audit procedures relied on by the auditor of record in forming their opinions on issuer's financial statements or internal controls over financial reporting. In addition, this would include the auditors of record that have obtained consents for

cooperation with the PCAOB and its staff in carrying out the PCAOB's responsibilities. Still, others may conclude that the requirement applies only to firms that "play a substantial role" in audits based on the Board's registration requirements. Therefore, we believe that further clarification is warranted.

Clarification of "associated person" criterion

Since the "associated person" criterion includes firm personnel, clarification is needed on whether the Board intends Rule 3523 to apply to newly admitted partners or newly hired professionals at the registered firms or their affiliated firms if these individuals previously performed tax services for restricted persons before making partner or beginning employment. Additionally, we encourage the Board to clarify whether and to what extent it intends Rule 3523 to apply to former partners or employees of registered firms who join other accounting firms or boutique tax-services firms and then provide tax services to restricted persons. An unduly restrictive interpretation of Rule 3523 applying to former partners or employees of registered firms may have unintended, limiting consequences on the employment of such individuals.

Limitations faced by privately held entities proposing to register with the Commission

Rule 3523 also creates uncertainty for the governing boards and newly constituted audit committees of privately held entities that propose registering with the Commission through an initial public offering, filing Forms 10-K or 10-K/SB or other registration documents, reverse mergers, or other filings. The interim PCAOB independence rules and the SEC independence rules require that the registered firms and their affiliated firms must be independent of potential registrants for all financial periods covered by auditors' reports included in such filings. For Grant Thornton's privately held audit clients, our firm and Grant Thornton International member firms frequently provide tax compliance and consulting services to our clients' principals, officers, and directors, some of whom will become restricted persons when they initially file registration statements with the Commission. We believe the Board should clarify how to apply Rule 3523 to newly constituted audit committees of privately held entities that propose to register with the Commission. We also suggest that the Board apply the 180-day transition period for a change in issuer status.

Conclusion

Rule 3523 prohibits registered accounting firms (including their affiliated firms or their associated persons) from concurrently providing tax compliance services to any restricted persons of issuer clients (including their material subsidiaries) and providing audit services to the issuer clients and their affiliates. The prohibition on providing these concurrent services removes the perception of mutuality of interest and protects the public interest. However, we believe that certain sections of Rule 3523 regarding clients' fiscal years before their engagement of registered firms impose unnecessary and potentially burdensome requirements on issuers' audit committees and registered firms. If the registered firms are not providing concurrent services during the clients' fiscal years, and if those services provided to individuals are not prohibited, such as recommending a confidential, listed, or aggressive tax position, then we believe that the termination of tax services

for restricted persons before registered firms are engaged by issuers should not limit an audit committee's determination of identifying a registered firm to provide audit services.

Further, for entities initially registering with the Commission, applying Rule 3523 to periods before they become registrants may create costly barriers to market entry. For example, if Rule 3523 is applied unilaterally to all financial periods included in initial registrations, the registrants may need to engage a different auditor to perform the audits for the financial periods included in the registration statement(s). Grant Thornton believes that the termination of engagements involving the provision of tax services to restricted persons before beginning the professional engagement period adequately safeguards against any apparent independence threats.

If, in response to question 2 above, the Board makes a technical correction to Rule 3523, Grant Thornton recommends that the Board define the term "material subsidiary" to coincide with integrated auditing standards or the Board's criteria, "performing a substantial role" for the registration of affiliated firms. Further, we would appreciate the Board's consideration of applying the 180-day transition period to a subsidiary whose materiality changes during the course of an issuer's fiscal period, consistent with such relief we believe is appropriate to implement Rule 3523 in a manner and spirit intended by the Board.

We believe that Rule 3523 as currently constructed creates significant impediments to audit committees' ability to change auditors. We have thus identified several areas requiring technical corrections or modifications to enhance Rule 3523's practicality and consistent application as a potential remedy.

We would be pleased to discuss our comments with you. If you have any questions, please contact Jeffrey Frishman, Managing Principal of Tax Quality Assurance, at 312-602-8810, or Karin French, Managing Partner of SEC/Regulatory, at 703-847-7533.

Very truly yours,

Grant Thornton LLP

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